

Private foundation; self-dealing; transfer of real property by disqualified person. A disqualified person's attempt to correct an act of self-dealing described in section 4941(d)(1)(B) of the Code by transferring to a private foundation real estate, the fair market value of which equals the amount of a loan made by the foundation to the disqualified person, is a second act of self-dealing.

ISSUE

Does a second act of self-dealing within the meaning of section 4941(d)(1) of the Internal Revenue Code occur when a disqualified person transfers assets other than money to correct an indebtedness to a private foundation which constituted the initial act of self-dealing?

FACTS

A private foundation loaned money to a disqualified person with respect to the foundation. When both parties realized that the loan was an act of self-dealing under section 4941(d)(1)(B) of the Code, the disqualified person proposed to correct the act of self-dealing by transferring to the private foundation a parcel of real estate with a fair market value purportedly equal to the amount of the debt.

LAW AND ANALYSIS

Section 4941(a)(1) of the Code imposes an initial tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(A) and (B) provides that the term 'self-dealing' means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person and any direct or indirect lending of money or other extension of credit between a private foundation and a disqualified person.

Section 4941(b)(1) of the Code imposes an additional tax in any case where an initial tax is imposed on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within an allowable correction period. Section 4941(e)(3) defines the term 'correction' with respect to any act of self-dealing as undoing the transaction to the extent possible but, in any case, placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.

Section 53.4941(d)-1(a) of the Foundation Excise Tax Regulations provides that, for purposes of determining whether a transaction is an act of self-dealing, it is immaterial whether the transaction results in a benefit or a detriment to the

private foundation.

Section 53.4941(e)-1(c) of the regulations illustrates the minimum standards of correction in the case of certain specific acts of self-dealing and provides that similar principles shall be applied with respect to other acts of self-dealing. In the case of the use of a foundation's property by a disqualified person, section 53.4941(e)-1(c)(4) states that undoing the transaction includes, but is not limited to, terminating the use of the property. The last sentence of section 53.4941(e)-1(c)(1) states that any correction pursuant to this paragraph of the regulations and section 4941 of the Code shall not be an act of self-dealing.

The proposed transfer of real property in this case would not be proper correction of the act of self-dealing because the minimum standards of section 53.4941(e)-1(c)(4) of the regulations would not be met. Even if the property is equal in value to the amount of the loan, it will be generally less advantageous to the foundation to receive the property than to have the loan repaid since it may be both difficult and costly for the foundation to convert the property to cash and thus restore its position.

Also, if the property were transferred in return for cancellation of the self-dealer's indebtedness to the foundation, the transaction would be considered a sale of property by the disqualified person to the private foundation and would itself be an act of self-dealing under section 4941(d)(1)(A) of the Code. The rule of section 53.4941(e)-1(c) of the regulations that any correction pursuant to that paragraph and section 4941 shall not be an act of self-dealing is not applicable as the proposed transfer of real property would not constitute proper correction of the original act of self-dealing.

Under certain circumstances, a transfer of property could be acceptable correction of a loan transaction that is an act of self-dealing. For example, if a disqualified person purchased property with money borrowed from a private foundation and the property increased substantially in value, transfer of the property to the foundation would be an acceptable substitute for repayment of the loan if it could be shown that the property could be converted readily into an amount of money in excess of the amount borrowed. The transfer would not only exceed the minimum standards of section 53.4941(e)-1(c)(4) of the regulations, but would be required by the rule of section 53.4941(e)-1(c)(1) that the foundation must be restored to a position no worse than if the disqualified person were dealing under the highest fiduciary standards.

HOLDING

An attempted correction of an initial act of self-dealing described in section 4941(d)(1)(B) of the Code by the transfer of

real estate purportedly equal in fair market value to the amount of the initial act of self-dealing constitutes a second act of self-dealing.